RECORD AND BRIEFS

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No. 15-649

In the Supreme Court of the United States

CASIMIR CZYZEWSKI, ET AL., PETITIONERS

v.

JEVIC HOLDING CORP., ET AL.

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE

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QUESTION PRESENTED

Whether a bankruptcy court may authorize a distribution of settlement proceeds that violates the priority scheme established by the Bankruptcy Code, over the objection of priority creditors whose rights are impaired by the proposed distribution.

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INTEREST OF THE UNITED STATES

This case presents the question whether a bankruptcy court may authorize a distribution of settlement proceeds in a manner that violates the priority scheme established in the Bankruptcy Code, 11 U.S.C. 101 *et seq.*, over the objection of priority creditors whose rights are impaired by the proposed distribution. That is an issue of substantial importance to the United States. The Attorney General appoints United States Trustees to supervise the administration of bankruptcy cases and trustees throughout the country. 28 U.S.C. 581-589a. United States Trustees "serve as bankruptcy watch-dogs to prevent fraud, dishonesty, and overreaching in the bankruptcy arena," H.R. Rep. No. 595, 95th Cong., 1st Sess. 88 (1977) (1977 Report), and they "may raise and may appear and be heard on any issue in any case or proceeding under" Title 11, 11 U.S.C. 307. The United States Trustee Pro-

gram thus acts in the public interest "to promote the integrity and efficiency of the bankruptcy system for the benefit of all stakeholders—debtors, creditors, and the public." U.S. Dep't of Justice, *United States Trustee Program Strategic Plan FY 2012-2016*, at 1, https://www.justice.gov/ust/strategic-plan-mission (last visited Sept. 1, 2016).

The United States is also the largest creditor in the Nation, frequently appearing as creditor in Chapter 11 cases. Certain tax claims, which by their nature involve debts owed to governmental units, have priority status in bankruptcy. 11 U.S.C. 503(b)(1)(B), 507(a)(2) and (8). In addition, several government agencies, including the Federal Deposit Insurance Corporation and the National Credit Union Administration, are entitled to assert priority claims in certain circumstances. See 11 U.S.C. 507(a)(2) and (9). Because a bankruptcy estate's assets are typically scarce, the United States has an interest in preventing bankruptcy courts from authorizing the distribution of estate assets in a manner that violates the rights of non-consenting priority creditors.

At the Court's invitation, the United States filed a brief as amicus curiae at the petition stage of this case.

STATEMENT

1. A company may file a bankruptcy petition pursuant to Chapter 7 or Chapter 11 of the Bankruptcy Code. In a Chapter 7 bankruptcy, the company's pre-petition assets are liquidated and distributed to creditors. 11 U.S.C. 701 *et seq.* A Chapter 11 bankruptcy, in contrast, is implemented through a "plan" that assigns to "classes" the various allowed claims and specifies the treatment each class of claims shall

receive, in exchange for a discharge of debts to the extent provided by the Code. 11 U.S.C. 1122, 1123, 1141.

In a Chapter 11 plan, each secured creditor typically is designated as a class unto itself. See Alan N. Resnik & Henry J. Sommer, 7 *Collier on Bankruptcy* ¶ 1122.03[3][c], at 1122-15 to 1122-16 (16th ed. 2016) (*Collier*). Among unsecured claims, the Code assigns "priority" to certain claims because of their "special social importance." S. Rep. No. 1106, 95th Cong., 2d Sess. 4 (1978) (1978 Report). Section 507—which applies to bankruptcies filed under Chapters 7 and 11, see 11 U.S.C. 103(a)—identifies claims entitled to priority and specifies the order in which they must be paid. 11 U.S.C. 507. Unsecured claims with priority include certain administrative expenses incurred during the bankruptcy proceeding; employee wages and benefits that were earned but not paid in the six months before the bankruptcy petition was filed; consumer deposits; and taxes. *Ibid.*

Under Section 507, wage claims have fourth priority, and contributions to employee benefit plans have fifth priority. 11 U.S.C. 507(a)(4) and (5). A bankruptcy court generally may confirm a proposed Chapter 11 plan only if each holder of a priority claim under Section 507 receives cash or deferred cash payments (depending on the circumstances) equal to the value of the claim as of the effective date of the plan, unless a particular claimholder "agree[s] to a different treatment of [its] claim." 11 U.S.C. 1129(a)(9). In addition to requiring that priority claimants be paid in full (unless they consent to different treatment), the Code establishes further prerequisites to plan confirmation with respect to non-priority unsecured credi-

tors. But full payment of Section 507 priority claims is a mandatory precondition of plan confirmation regardless of how other unsecured creditors may be treated under a plan. In a Chapter 7 liquidation, unsecured creditors with Section 507 priority claims are paid "in the order specified" in Section 507, 11 U.S.C. 726(a)(1), and other unsecured claimants may not receive any payments unless the priority claims are paid in full, 11 U.S.C. 726(a)(2).

While a bankruptcy case is pending, any legal claims the estate has against its creditors and others may be litigated or settled, usually by the debtor in possession or a trustee. During the pendency of a bankruptcy, a claim by a creditor that a debtor's assets were depleted by a fraudulent conveyance becomes a claim of the estate and is assigned to the trustee to pursue on behalf of the estate. 11 U.S.C. 544(b); see 11 U.S.C. 548(a) (trustee has exclusive right to pursue fraudulent-conveyance action in bankruptcy). In a Chapter 11 bankruptcy, such a claim (and others) may be pursued by a debtor in possession, who generally has the rights of a trustee. 11 U.S.C. 1107. In some circumstances, a bankruptcy court may authorize a committee of creditors to pursue claims on behalf of the estate. 11 U.S.C. 1103. A bankruptcy court may approve settlement of an estate claim if, after notice and a hearing, the court determines that the settlement is fair and equitable. Fed. R. Bankr. P. 9019, 11 U.S.C. App. at 757; see *Protective Comm. for Indep. Stockholders of TMT Trailer Ferry, Inc.* v. *Anderson*, 390 U.S. 414, 424 (1968). Any proceeds from the litigation or settlement of the estate's claims become estate property subject to distri-

bution under the normal rules of priority. 11 U.S.C. 541(a)(3) and (6).

If the estate of a Chapter 11 debtor lacks sufficient funds to pay the priority claimholders in full in accordance with Section 1129(a)(9)(A)-(D) (typically in cash or deferred payments), and the priority claimants do not agree to different treatment under a plan, the case can either be converted to a Chapter 7 liquidation or dismissed. 11 U.S.C. 1112. An order of dismissal in a bankruptcy case ordinarily has the effect of vacating most orders entered during the proceedings and "revest[ing] the property of the estate in the entity in which such property was vested immediately before the commencement of the case" (usually the debtor). 11 U.S.C. 349(b)(3); see 11 U.S.C. 349(b)(2). The "objective" of a dismissal "is to undo the title 11 case, insofar as is practicable, and to restore all property rights to the position they occupied at the beginning of such case." 3 *Collier* ¶ 349.01[2], at 349-3. The bankruptcy court has discretion to alter the effects of its dismissal "for cause," 11 U.S.C. 349, such as by leaving its orders in force to protect the reliance interest of a good-faith purchaser, 3 *Collier* ¶ 349.01[2], at 349-3. Otherwise, if a Chapter 11 case is dismissed, creditors retain their pre-petition claims against the debtor (and any related fraudulent-conveyance claims they previously had against third parties) and can pursue them outside bankruptcy. 11 U.S.C. 349(b).

2. This case arises out of the bankruptcy of respondent Jevic Transportation, Inc. (Jevic), a trucking company, following its acquisition by respondent Sun Capital Partners (Sun) in a leveraged buyout. Pet. App. 2a. Sun financed the transaction by borrowing

against Jevic's assets. C.A. App. 733-734 (September 15, 2011, bankruptcy court opinion). When Jevic subsequently refinanced the loan, respondent CIT Group/Business Credit, Inc. (CIT) became the primary lender and obtained a lien on all of Jevic's assets. Pet. App. 36a; C.A. App. 734. In response to Jevic's deteriorating financial condition, Sun agreed to guarantee $2 million of Jevic's debt in exchange for CIT's agreement not to foreclose on Jevic's assets for a period of time. Pet. App. 2a; C.A. App. 735, 1162. Shortly before that agreement expired, Jevic's board of directors authorized a bankruptcy filing. Pet. App. 2a. Jevic then ceased substantially all of its operations, notified its employees that they would be fired, and filed a Chapter 11 bankruptcy petition. *Id.* at 2a-3a. When that petition was filed, Jevic owed approximately $53 million to CIT and Sun, who were first-priority secured creditors. *Id.* at 3a, 36a n.2.

As relevant here, two suits were filed in the bankruptcy court, one seeking to establish the estate's liabilities and the other asserting claims of the estate. First, petitioners—a group of Jevic's employee truck drivers—alleged violations of state and federal laws known as Worker Adjustment and Retraining Notification (WARN) Acts, which require in some circumstances that an employer give written notice to employees at least 60 days before laying them off. Pet. App. 3a (citing 29 U.S.C. 2102; and N.J. Stat. Ann. § 34:21-2 (West 2011)). The bankruptcy court granted summary judgment to petitioners on their claims against Jevic. *Id.* at 5a & n.2. An estimated $8.3 million dollars of petitioners' WARN Act claim is a priority wage claim under 11 U.S.C. 507(a)(4). Pet. App. 6a.

Second, after an Official Committee of Unsecured Creditors (Committee) was appointed to represent the interests of Jevic's unsecured creditors, the bankruptcy court authorized the Committee to pursue a fraudulent-conveyance action against Sun and CIT on behalf of the estate. Pet. App. 3a. The Committee alleged that Sun, with CIT's assistance, had "acquired Jevic with virtually none of its own money" and had "hastened Jevic's bankruptcy by saddling it with debts that it couldn't service." *Ibid.* (citation omitted). The Committee's complaint alleged, *inter alia*, that Sun's and CIT's liens were avoidable and that certain assets with significant value must be disgorged to the estate. See C.A. App. 764-854.

The bankruptcy court ultimately denied in part and granted in part Sun's and CIT's motion to dismiss the fraudulent-conveyance action, concluding that the Committee had adequately pleaded claims of fraudulent transfer and preferential transfer under 11 U.S.C. 547 and 548. Pet. App. 3a-4a. The court explained that "[a]n overly leveraged buyout that leaves the target company with unreasonably small capital—where it is reasonably foreseeable that the target will soon thereafter become insolvent—may provide the requisite factual predicate for an avoidance action grounded in fraudulent transfer law." C.A. App. 751. The court concluded that the Committee's complaint sufficiently alleged that CIT had played a critical role in facilitating a series of transactions that recklessly reduced Jevic's equity, increased its debt, and shifted the risk of loss to its other creditors. Pet. App. 4a.

The Committee, Jevic, CIT, and Sun then sought to negotiate a settlement of the Committee's fraudulent-conveyance action. Pet. App. 4a. By that point, Jev-

ic's only assets were the fraudulent-conveyance claim against CIT and Sun, and $1.7 million in cash, which was subject to Sun's lien. *Ibid.* The parties to the negotiations ultimately reached an agreement that would accomplish four things: (1) those parties would exchange releases of their claims against each other, and the bankruptcy court would dismiss the estate's fraudulent-conveyance action with prejudice; (2) CIT would pay $2 million into an account earmarked to pay Jevic's and the Committee's legal fees and other administrative expenses, but not otherwise available for distribution to creditors; (3) Sun would assign its lien on Jevic's remaining $1.7 million to a trust that would pay tax and administrative creditors, with the remainder to be distributed on a pro rata basis to the general unsecured creditors (but not to petitioners, who are higher-priority creditors); and (4) Jevic's Chapter 11 bankruptcy would be dismissed. *Id.* at 5a-6a. The proposed settlement did not provide for any payment to petitioners on their higher-priority WARN Act claims, and it left Jevic with no assets to satisfy those claims outside bankruptcy. *Id.* at 5a-7a.

3. The Committee, Jevic, CIT, and Sun moved in the bankruptcy court for approval of the settlement. See Pet. App. 53a. Petitioners and the United States Trustee opposed that motion, on the grounds that the proposed settlement would distribute estate assets to creditors of lower priority than petitioners, in contravention of the Bankruptcy Code's priority scheme, and that the Code does not contemplate or permit relief other than a confirmed plan, a Chapter 7 liquidation, or an outright dismissal. *Id.* at 7a, 53a, 57a.

In an oral ruling, the bankruptcy court granted the motion to approve the settlement, which it described

as a "global resolution" reached by "certain of the parties." Pet. App. 55a; see *id.* at 53a-66a. The court acknowledged that this type of resolution "is certainly neither favored nor commonplace"; that "no express[] provision in the code" authorizes the "distribution and dismissal contemplated by the settlement motion"; and that "the proposed distributions are not in accordance with the" Code's priority scheme. *Id.* at 57a, 58a. The court nevertheless approved the proposed disposition, explaining that, "because this is not a plan, and there is no prospect of a confirmable plan being filed, the absolute priority rule is not a bar to approval of this settlement." *Id.* at 58a. Because CIT and Jevic had liens on all of the estate's assets, the bankruptcy court determined that a disposition that would make money available to the unsecured creditors and some priority creditors was in the interest of the creditors as a group. *Id.* at 58a, 61a.

The bankruptcy court stated that the fairness of the proposed settlement depended in part on the likelihood that the Committee would ultimately prevail in its fraudulent-transfer action if that suit were litigated to its conclusion. Pet. App. 59a-60a. The court noted several "independent hurdles that the Committee would have to clear before it would actually see a material recovery out of the litigation." *Id.* at 60a. The court also noted that the estate (unlike CIT and Sun) had no available funds and would have a difficult time retaining counsel to pursue the case, notwithstanding the possibility of retaining contingency counsel or a Chapter 7 Trustee to continue the litigation. *Id.* at 61a. The bankruptcy court also concluded that petitioners were not prejudiced by dismissal of the case on those terms because petitioners' collective

WARN Act "claim against the estate [was] presently, effectively worthless given that the estate lack[ed] available unencumbered funds to satisfy it if it were allowed." *Ibid.*

4. The district court affirmed. Pet. App. 33a-43a. While stating that "the settlement does not follow the absolute priority rule," the court held that this deviation was "not a bar to the approval of the settlement as [the settlement] is not a reorganization plan." *Id.* at 42a. The court also concluded that "the settlement was in the best interest of the estate." *Id.* at 41a.

5. The court of appeals affirmed. Pet. App. 1a-23a. The court first held that a bankruptcy court has discretion to order a "structured dismissal" of a Chapter 11 bankruptcy, at least when there is "no prospect of a confirmable plan" and conversion to Chapter 7 would not be "worthwhile." *Id.* at 15a; see *id.* at 12a-15a. The court further held that a bankruptcy court may order such a "structured dismissal" even when the "settlement[] * * * skip[s] a class of objecting creditors in favor of more junior creditors." *Id.* at 15a; see *id.* at 15a-21a.

The court of appeals observed that the Second and Fifth Circuits had rendered conflicting decisions regarding the propriety of such settlements. Pet. App. 17a-18a. It sided with the Second Circuit, which had held that "the absolute priority rule 'is not necessarily implicated' when 'a settlement is presented for court approval apart from a reorganization plan.'" *Id.* at 18a (quoting *In re Iridium Operating LLC*, 478 F.3d 452, 463 (2d Cir. 2007) (*Iridium*)). The court of appeals rejected the approach adopted by the Fifth Circuit, which had held "that the 'fair and equitable' standard applies to settlements, and 'fair and equita-

ble' means compliant with the priority system." *Id.* at 17a (quoting *In re AWECO, Inc.*, 725 F.2d 293, 298 (5th Cir.) (*AWECO*), cert. denied, 469 U.S. 880 (1984)). Instead, the court followed the Second Circuit in holding that, although "'compli[ance] with the Code's priority scheme must be the most important factor for the bankruptcy court to consider when determining whether a settlement is "fair and equitable" under Rule 9019,' * * * a noncompliant settlement could be approved when 'the remaining factors weigh heavily in favor of approving a settlement.'" *Id.* at 18a (quoting *Iridium*, 478 F.3d at 464).

The court of appeals held that the settlement and structured dismissal of Jevic's bankruptcy case was "the least bad alternative since there was 'no prospect' of a plan being confirmed and conversion to Chapter 7 would have resulted in the secured creditors taking all that remained of the estate in 'short order.'" Pet. App. 21a (quoting C.A. App. 32). While acknowledging that "the exclusion of [petitioners] certainly lends an element of unfairness," the court considered the critical question to be whether the settlement serves the interests of the "estate and the creditors as a whole," not "one particular group of creditors." *Id.* at 22a.

Judge Scirica dissented. Pet. App. 23a-32a. He stated that "the bankruptcy court's order undermined the Code's essential priority scheme." *Id.* at 23a. Although Judge Scirica would have followed the Second Circuit in permitting settlements contrary to the priority scheme in "extraordinary circumstances," he disagreed with the majority's conclusion that "this appeal presents an extraordinary case." *Id.* at 24a. He explained that it is "not unusual" for a debtor to enter Chapter 11 bankruptcy proceedings with liens

on all of its assets and with the goal of liquidating. *Id.* at 31a; see *id.* at 31a n.5 (citing study showing that 22% of surveyed companies entered Chapter 11 with secured claims exceeding the value of the estate). He further explained that, "to the extent that the only alternative to the settlement was a Chapter 7 liquidation, that reality was, at least in part, a product of [the settling parties'] own making." *Id.* at 25a.

SUMMARY OF ARGUMENT

A. The Bankruptcy Code establishes a detailed and interconnected set of protections for debtors, creditors, and the public. One integral feature of that scheme, which reflects bankruptcy practice that long predated the Code, is its identification of specific types of claims that are entitled to priority of payment. See 11 U.S.C. 507. A Chapter 11 plan of reorganization cannot be confirmed unless *either* claims that have priority status under Section 507 are paid in full *or* the holders of such claims consent to a different treatment. Congress has long identified employee wage claims as priority claims, and that treatment reflects Congress's judgment that payment of such claims serves especially important public interests. A bankruptcy court may not override that judgment based on its perception that a different allocation of estate assets would be fairer or more efficient.

If a bankruptcy estate lacks sufficient funds to pay all Section 507 priority creditors in full, and the priority creditors do not consent to less favorable treatment, the Code provides for conversion to Chapter 7 or dismissal of the bankruptcy case. If a case is converted to Chapter 7, priority creditors must be paid first, and in the order specified in Section 507, before any other unsecured creditors can receive estate as-

sets. If a case is dismissed, creditors can pursue their claims outside bankruptcy, pursuant to applicable non-bankruptcy state and federal law. Dismissal of the present case would have left petitioners free to pursue their WARN Act claims against Jevic, and to attempt to make assets available to pay any favorable judgment by pursuing a fraudulent-transfer claim against Sun and CIT.

The court of appeals appeared to recognize that the distribution of estate assets that occurred here, in which petitioners received nothing even though non-priority unsecured creditors received a portion of the estate's funds, would not have been permissible in a Chapter 11 reorganization plan or in a Chapter 7 liquidation. The court believed, however, that the constraints imposed by Section 507's priority rules do not apply to a distribution of estate assets that is undertaken pursuant to a structured dismissal of a case rather than pursuant to confirmation of a bankruptcy plan. That was error. Chapter 5 of the Code (which includes Section 507) applies to all "case[s] under," *inter alia*, Chapters 7 and 11, 11 U.S.C. 103(a), and Jevic's bankruptcy was a "case under" Chapter 11 even though it did not culminate in confirmation of a plan. Nothing in the Code authorized the bankruptcy court to use the expedient of case dismissal as a substitute for plan confirmation in order to distribute estate assets in a manner inconsistent with Section 507's priority scheme.

B. The court of appeals was also wrong in upholding the bankruptcy court's distribution of estate assets on the ground that the Code's priority rules do not apply to "settlements." To be sure, by providing that Section 507's priority rules apply to Chapter 11

plans "[e]xcept to the extent that the holder of a particular claim has agreed to a different treatment of such claim," 11 U.S.C. 1129(a)(9), the Code does contemplate that a particular priority creditor can validly consent to an impairment of the rights it would otherwise possess. The court below, however, invoked the purported "settlement" exception to the Code's priority rules to justify the bankruptcy court's impairment of petitioners' rights as priority creditors *over their objection*, on the ground that the proposed distribution of estate assets would best serve "the creditors as a whole." Pet. App. 22a. Neither the Code itself, nor the background rules that generally govern settlement of litigation, suggest that the consent of *other* parties to a bankruptcy can justify a deviation from the Code's priority scheme.

The bankruptcy court sought to justify its disposition on the ground that petitioners' WARN Act claims were "worthless" as a practical matter because the estate lacked unencumbered funds to pay a judgment in petitioners' favor. Pet. App. 61a. That assessment of the practical value of petitioners' claims rested in turn on the court's perception that the estate's fraudulent-conveyance claim against Sun and CIT was too contingent and uncertain to merit pursuit. If the bankruptcy had simply been dismissed, however, petitioners could have made their own determination whether to pursue a fraudulent-transfer action that, if successful, would have made funds available to satisfy a favorable WARN Act judgment. Because one term of the bankruptcy court's disposition was to dismiss the estate's fraudulent-transfer action with prejudice, that disposition effectively prevented petitioners from recovering on their

WARN Act claims. The bankruptcy court's disposition thus improperly deprived petitioners of their priority rights and their fraudulent-conveyance claim while giving them nothing in return.

ARGUMENT

The Bankruptcy Code prescribes a detailed scheme for resolving claims against an insolvent debtor. That scheme reflects Congress's careful balancing of competing interests and provides important protections for both debtors and creditors. See H.R. Rep. No. 996, 102d Cong., 2d Sess. 12-13 (1992) (1992 Report). The administration of a bankruptcy case is not a free-for-all in which the bankruptcy court may dispose of claims and distribute assets as it sees fit. Rather, although bankruptcy courts "are courts of equity and 'appl[y] the principles and rules of equity jurisprudence,'" *Young* v. *United States*, 535 U.S. 43, 50 (2002) (brackets in original) (quoting *Pepper* v. *Litton*, 308 U.S. 295, 304 (1939)), their discretion is limited by the detailed scheme set forth in the Code, which reflects Congress's effort to strike a balance that is fair, equitable, and sufficiently flexible to accommodate the interests of debtors, creditors, and the public.

In this case, the bankruptcy court ignored the carefully crafted options that Congress made available in a Chapter 11 case and instead approved a distribution of estate assets that contravenes the Code's priority scheme. The court of appeals offered two basic justifications for approving that disposition. First, the court of appeals relied on the fact that the bankruptcy court had dismissed the case rather than confirming a Chapter 11 plan of reorganization. Second, the court viewed the Code's priority rules as inapplicable to bankruptcy "settlements." Pet. App. 58a-61a. As we

explain below, neither of those rationales justifies the bankruptcy court's disposition of this case, which deprived petitioners of their rights as priority creditors *without* their consent.

A. The Courts Below Erred By Approving A Distribution Of Estate Assets In A Manner Not Provided For In The Bankruptcy Code

Under the rules set forth in the Bankruptcy Code, both debtors and creditors lose certain rights they would otherwise possess while receiving certain protections. In the Chapter 11 context, a corporate debtor gives up the right to control the distribution of its assets, and a creditor gives up its state-law right to seek full repayment on its claim. In exchange, a Chapter 11 debtor enjoys protections such as the automatic stay that generally freezes efforts to collect pre-petition debts, 11 U.S.C. 362; and the discharge of liability on debts that are addressed in a plan of reorganization, 11 U.S.C. 1141(d); see *Burlingham* v. *Crouse*, 228 U.S. 459, 473 (1913) (noting that the Bankruptcy Code "give[s] the bankrupt a fresh start with such * * * rights as the [bankruptcy] statute left untouched"). A Chapter 11 creditor can rely on protections such as the Code's detailed priority scheme, which requires that certain types of creditors be paid in full through a bankruptcy before other types of creditors may receive any distribution, 11 U.S.C. 507; and the rule that a plan of reorganization may not pay a junior class of creditors or interests unless every senior class is either unimpaired or consents to impairment, 11 U.S.C. 1129(a)(8) and (b)(1). In this case, the lower courts held that a bankruptcy court may upend this carefully balanced system by approving the disposition of a case in a manner

that is not authorized by the Code and that does not respect the protections Congress has extended to particular types of creditors. The Bankruptcy Code does not allow such a disposition.

The "uniform national bankruptcy system * * * is designed to achieve two equally important objectives": "to provide honest debtors who have fallen on hard times the opportunity for a fresh start in life," and "to protect creditors in general by preventing an insolvent debtor from selectively paying off the claims of certain favored creditors at the expense of others." 1992 Report 12-13; H.R. Rep. No. 835, 103d Cong., 2d Sess. 32-33 (1994) (1994 Report) (same). Recognizing the "inevitable temptation among creditors to fiercely compete over the debtor's limited funds," Congress designed a system "in which the claims of all creditors are considered fairly, in accordance with established principles rather than on the basis of the inside influence or economic leverage of a particular creditor." 1992 Report 13; see 1994 Report 33. In pursuit of those goals, the Bankruptcy Code contemplates three possible dispositions of a Chapter 11 case: a plan of reorganization, conversion to a Chapter 7 bankruptcy, or dismissal of the case. The bankruptcy court exceeded its authority when it ordered a fourth type of disposition that does not comply with the Code provisions applicable to any of the three dispositions contemplated by the Code.

1. To achieve a fair and orderly disposition of creditors' claims in a Chapter 11 bankruptcy, Congress created a set of rules to govern plans of reorganization. 11 U.S.C. 1121-1129. One essential feature of the statutory scheme is its identification of specific types of claims that are entitled to priority of pay-

ment. The overarching principle of plan construction (implemented in two steps) is that claimholders (or classes of claimholders) with senior priority must either be paid in full or consent to impairment before a plan may provide for payment to claims or classes of claims or interests that are junior.

a. In the bankruptcy context, the term "priority" has long been used to refer to claims that are entitled to be paid before other claims. See *United States* v. *Bryan & Woodcock*, 13 U.S. (9 Cranch) 374, 387 (1815). In Section 507 of the Code, 11 U.S.C. 507, Congress granted "priority" status to a "narrow[] set of specified types of claims, including certain tax obligations and limited past due wages to a debtor's employees," by requiring that such claims "be paid in full" before non-priority (or lower-priority) creditors receive "any distribution." 1992 Report 13; see 1994 Report 33; 1978 Report 4 (noting that the Code "giv[es] priority in the distribution of assets of the debtor's estate to certain claims with special social importance"). Section 507 applies to most bankruptcy proceedings, including cases filed under Chapters 7 and 11, see 11 U.S.C. 103(a), and generally "affect[s] claims of unsecured creditors," 1978 Report 4.

Section 507 provides that certain enumerated "expenses and claims have priority in the * * * order" specified. 11 U.S.C. 507(a). Because that provision "appl[ies] in a case under chapter 7, 11, 12, or 13," 11 U.S.C. 103(a), it governs Jevic's Chapter 11 bankruptcy. In the Chapter 11 context, a plan of reorganization cannot be confirmed unless *either* claims that are afforded priority status by operation of Section 507 are paid in full (with cash or deferred cash payments) *or* the holders of such claims consent to a dif-

ferent treatment. 11 U.S.C. 1129(a)(9). That requirement applies regardless of how other claims are treated in a reorganization plan.

Since the earliest American bankruptcy laws, Congress has sought to achieve "the equitable distribution of the debtor's assets amongst his creditors." *Kuehner* v. *Irving Trust Co.*, 299 U.S. 445, 451 (1937); see *United States* v. *Embassy Rest., Inc.*, 359 U.S. 29, 31 (1959) (same). Because many bankruptcy estates do not have sufficient assets to pay all creditors in full, the Code establishes rules for allocating the existing assets among the holders of claims. If parity of treatment were Congress's only objective in drafting the Code, Congress would have provided for a pro rata distribution of assets among all creditors (or perhaps among all unsecured creditors after secured claims were satisfied). See 4 *Collier* ¶ 507.02[1], at 507-13. Instead, Congress has long chosen to prefer certain types of claims over other types of claims.

The statutory provisions that assign priority to certain claims reflect Congress's policy determination that full payment of those claims, when possible, is in the public interest. The type of priority claim at issue here—employee wage claims—has enjoyed priority status since at least 1841. See *Embassy Rest.*, 359 U.S. at 31 & n.4 (citing Act of Aug. 19, 1841, ch. 9, § 5, 5 Stat. 445); 4 *Collier* ¶ 507.06[1], at 507-27 ("A priority for wages was included as part of the Bankruptcy Act upon its original enactment in 1898 and has been a feature of the bankruptcy law since that time."). Congress's objective in establishing that priority "has constantly been to enable employees displaced by bankruptcy to secure, with some promptness, the money directly due to them in back wages, and thus to

alleviate in some degree the hardship that unemployment usually brings to workers and their families." *Embassy Rest.*, 359 U.S. at 32; see *id.* at 33 ("[T]he purpose for which Congress established the priority * * * was to provide the workman a 'protective cushion' against the economic displacement caused by his employer's bankruptcy."); 4 *Collier* ¶ 507.02[1][d], at 507-14 ("Employees are viewed as having a special right to payment since their labor has helped to create the assets from which other creditors will be able to realize value and because their wages are often their only source of income. Creditors other than employees generally have not relied on the debtor as their sole source of income.").

Congress has similarly accorded priority status to tax claims since the early days of the Nation's bankruptcy laws. 4 *Collier* ¶ 507.LH[1], at 507-92. "[T]axes are the life-blood of government," *Bull* v. *United States*, 295 U.S. 247, 259 (1935), and taxing entities (like employees, but unlike most Chapter 11 creditors) do not extend credit voluntarily. Compare 1977 Report 190 (explaining that a "taxing authority is given preferred treatment because it is an involuntary creditor of the debtor"), with 4 *Collier* ¶ 507.02[1][d], at 507-14 ("[E]mployees in waiting for their paychecks do not consider themselves as extending credit to the debtor."). Although this case does not present any question concerning the proper treatment of tax claims, such claims are frequently at issue in Chapter 11 bankruptcies.

By giving statutory priority to wage claims, tax claims, and the other types of claims identified in Section 507 (including, *inter alia*, domestic-support obligations, administrative expenses, and contribu-

tions to employee benefit plans, 11 U.S.C. 507(a)(1), (2), and (5)), Congress has expressed its judgment that those claims have "special social importance." 1978 Report 4. That judgment may not be overridden by a bankruptcy court, at least absent the type of misconduct, not present here, that would justify equitable subordination of a priority claim pursuant to 11 U.S.C. 510(c). See *United States* v. *Noland*, 517 U.S. 535, 540-543 (1996).

b. As noted, the full payment of claims entitled to priority under Section 507 is a prerequisite to the confirmation of any Chapter 11 plan, unless the holder of a priority claim consents to less favorable treatment. 11 U.S.C. 1129(a)(9). The general principle that some claims must be paid before other claims may receive any distribution is also reflected in the rules that govern the treatment in a plan of classes of other unsecured creditors (*i.e.*, those with non-priority claims). An unsecured claim that is not entitled to priority under Section 507 must be assigned to a class, either alone or with other "substantially similar" claims. 11 U.S.C. 1122(a). Then, as a condition of confirmation, a plan must conform to the "absolute priority rule," 1977 Report 413, by providing for the distribution of estate assets such that a senior class of claims must receive the value of its claims before any junior class of claims or interests receives any distribution. See 11 U.S.C. 1129(b). That condition is reflected in the requirement that any plan be "fair and equitable," 11 U.S.C. 1129(b)(1), a phrase that has long been construed in the Chapter 11 context to require that a plan conform to the absolute priority rule. See *Northwest Bank Worthington* v. *Ahlers*, 485 U.S. 197, 202 (1988); George M. Treister et al. *Fundamen-*

tals of Bankruptcy Law § 9.04(f)(1), at 423 (5th ed. 2004). As with Section 507 priority, parties to a bankruptcy may depart from the absolute priority rule, but only when the class of claimholders whose rights would be impaired by a contemplated disposition of assets consents to the impairment. 11 U.S.C. 1129(a)(8) and (b)(2)(B).[1]

2. If a bankruptcy estate lacks sufficient funds to pay Section 507 priority creditors in full, and the priority creditors do not consent to less favorable treatment, the Code provides for two other options: conversion to Chapter 7 or dismissal. Both of those dispositions respect the relative rights of creditors, as determined by Congress and state legislatures.

Conversion of a Chapter 11 case to Chapter 7 typically takes place when an estate does not have sufficient assets to pay all creditors who are entitled to priority under Section 507. After conversion, the rights of priority creditors are protected by Chapter 7's requirement that priority creditors must be paid first and in the order specified in Section 507. 11 U.S.C. 726(a). That requirement ensures that a claim with relatively lower priority within Section 507 can-

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[1] In discussing the governing legal principles, the court below referred repeatedly to the "absolute priority rule." See Pet. App. 16a-17a. As noted, the term "absolute priority rule" is most accurately used to refer to the requirement in 11 U.S.C. 1129(b) that junior classes of creditors may not be paid through a plan of reorganization unless senior classes of creditors either receive the full value of their allowed claims or consent to an impairment of their rights. The court of appeals used the phrase to encompass the additional rule that, unless they consent to less favorable treatment, creditors with claims entitled to priority under Section 507 must be paid in full through a plan before any lower-priority (or non-priority) creditor is paid.

not be paid unless all claimholders with higher priority have been fully paid.

In the alternative, a Chapter 11 case that does not (or cannot) result in a confirmable plan of reorganization (or liquidation, see 11 U.S.C. 1123(b)(4)) can be dismissed. 11 U.S.C. 349. Such a dismissal leaves creditors free to pursue their claims outside bankruptcy, pursuant to applicable non-bankruptcy state and federal law. 11 U.S.C. 349(b). When a bankruptcy is dismissed, the requirements and protections established by the Code no longer apply, and the parties recover the rights that they lost during the pendency of the bankruptcy case. If the bankruptcy court had dismissed this case, petitioners would have been free to pursue their WARN Act claims against Jevic and a fraudulent-conveyance claim against Sun and CIT. See pp. 31-32, *infra*.

3. The court of appeals held that a bankruptcy court may dispose of a Chapter 11 case in a manner that is not authorized by the Code and that violates the priority scheme set forth in Section 507. The court erred by approving a bankruptcy disposition that furthered the interests of the debtor and non-priority creditors at the expense of objecting priority creditors.

The court below appeared to recognize that a plan of reorganization must provide full payment to Section 507 priority creditors unless such creditors consent to less favorable treatment. Pet. App. 16a-17a. The court concluded, however, that the same principle does not apply when the disposition of a bankruptcy case does not involve a plan of reorganization or a liquidation under Chapter 7. *Id.* at 17a. Nothing in the Code supports that conclusion. On the contrary,

as noted, the Code specifies that Chapter 5 (which includes Section 507) applies to all "case[s] under," *inter alia*, Chapters 7 and 11. 11 U.S.C. 103(a). Although Jevic's bankruptcy did not culminate in confirmation of a plan, it was a "case under" Chapter 11, and any disposition of estate assets authorized by the terms of its dismissal therefore was subject to the priority scheme set forth in Section 507.

Although the priority scheme set forth in Section 507 is not inviolable, Congress has specified the circumstances in which a court may deviate from that scheme, and none of those circumstances was present here. See, *e.g.*, 11 U.S.C. 726(a) (incorporating "equitable subordination" exception in 11 U.S.C. 510, which permits a bankruptcy court to reorder particular priority claims in a Chapter 7 liquidation); 11 U.S.C. 1129(a)(9), 1222(a)(2)(B), 1322(a) (authorizing plan confirmation when a priority creditor consents to abrogation of its rights). "Where Congress explicitly enumerates certain exceptions to a general prohibition, additional exceptions are not to be implied, in the absence of evidence of a contrary legislative intent." *Hillman* v. *Maretta*, 133 S. Ct. 1943, 1953 (2013) (quoting *Andrus* v. *Glover Constr. Co.*, 446 U.S. 608, 616-617 (1980)). No such evidence exists here.

Congress could have created a system in which individual bankruptcy courts would apply principles of fairness or equity to determine which Chapter 11 claims should be paid in full and which should be paid in part or not at all. Congress did not do that. Congress instead created a clear and detailed set of rules to "standardize[] an expansive (and sometimes unruly) area of law." *RadLAX Gateway Hotel, LLC* v. *Amalgamated Bank*, 132 S. Ct. 2065, 2073 (2012); see James

M. Henderson, 6 *A Treatise on the Bankruptcy Law of the United States* § 2778, at 343 (5th ed. 1952) (noting, with respect to the pre-Code Bankruptcy Act, ch. 541, 30 Stat. 544, that "[n]o power exists in a court of bankruptcy to accord priority of payment to a general creditor on broad principles of equity jurisprudence").

"[I]n exercising [its] statutory and inherent powers, a bankruptcy court may not contravene specific statutory provisions." *Law* v. *Siegel*, 134 S. Ct. 1188, 1194 (2014). The Code provides for three possible dispositions of a Chapter 11 case: (1) a plan of reorganization; (2) conversion to Chapter 7; or (3) dismissal. Nothing in the Code authorizes a court to approve a disposition that is essentially a substitute for a plan but does not comply with the priority scheme set forth in Section 507. That is what the bankruptcy court did here, and the court of appeals erred in affirming that disposition.

B. The Code Does Not Permit A Bankruptcy Court To Abrogate The Rights Of Nonconsenting Priority Claimholders Based On The Agreement Of Other Parties

In approving the bankruptcy court's disposition of this case, the court of appeals also relied on the purported status of that disposition as a voluntary "settlement." See Pet. App. 17a-21a. That was error. Although *other* parties to the case agreed to the bankruptcy court's disposition, those parties had no authority to settle petitioners' own priority claims. Their agreement consequently provided no sound basis for the court to deviate from the Code's priority scheme at petitioners' expense.

1. The court of appeals concluded that the Code's priority rules "do not extend * * * to settlements in bankruptcy." Pet. App. 20a. As noted, the Code specifies that Section 507 (which is included in Chapter 5) applies to all "case[s] under," *inter alia*, Chapters 7 and 11. 11 U.S.C. 103(a). Despite the bankruptcy court's conclusion that no confirmable plan of reorganization could be devised, the case remained a "case under" Chapter 11 and was therefore subject to the priority scheme set forth in Section 507.

Because Section 507's priority rules apply to Chapter 11 plans "[e]xcept to the extent that the holder of a particular claim has agreed to a different treatment of such claim," 11 U.S.C. 1129(a)(9), a particular priority creditor can validly consent to an impairment of the rights it would otherwise possess. The court below, however, invoked the purported "settlement" exception to the Code's priority rules to justify the bankruptcy court's impairment of petitioners' rights as priority creditors *over their objection*, on the ground that the proposed distribution of estate assets would best serve "the creditors as a whole." Pet. App. 22a. Neither the Code itself, nor the background rules that generally govern settlement of litigation, support that result. To the contrary, by authorizing "the holder of a particular claim" to "agree[] to a different treatment of such claim," 11 U.S.C. 1129(a)(9), the Code reinforces the natural inference that *other* parties cannot give valid consent to impairment of a priority creditor's rights.

The court of appeals believed that bankruptcy courts should have "more flexibility in approving settlements than in confirming plans of reorganization." Pet. App. 20a. But the Code itself provides

the best evidence of the kind and degree of flexibility that Congress deemed appropriate. A bankruptcy court is permitted to approve a disposition of a case that is not specifically provided for in the Code when *all* of the parties whose rights would be impaired by that disposition have consented. That degree of flexibility did not exist under pre-Code versions of the Bankruptcy Act. See *Fundamentals of Bankruptcy Law* § 903(f)(1), at 423. But under the Code, plan rules are flexible when creditors agree to impairment of their rights, and "Chapter 11 is flexible enough to accommodate whatever deal the parties with creditor or equity interests in the debtor can work out among themselves." *Id.* § 9.03(b), at 387.

The court of appeals justified the bankruptcy court's disposition of the case by stating that no other option "would have better served * * * the creditors as a whole." Pet. App. 22a. That reasoning was misguided. In certain carefully calibrated respects, the Code protects "creditors as a whole," by allowing parties to work out consensual compromises in crafting a Chapter 11 plan, and by permitting majority-rule approval of a plan within a class of impaired unsecured creditors (who are not protected under Section 507), even over the objection of a particular creditor within the class. But the Code's priority scheme unambiguously gives some creditors a right to collect that is superior to that of other creditors. That hierarchical system cannot function in its intended manner if individual judges feel free to disregard it based on the perceived interests of "the creditors as a whole."

2. Bankruptcy Rule 9019 authorizes a bankruptcy court to approve a "compromise or settlement." Fed.

R. Bankr. P. 9019, 11 U.S.C. App. at 757. That rule typically governs the settlement of a claim of the estate against a third party (including a creditor). A bankruptcy court may approve a settlement over the objection of a creditor if the court determines that the proposed settlement is "fair and equitable," after considering the nature of the claim and the likely range of outcomes if the estate were to pursue the claim to judgment. *Protective Comm. for Indep. Stockholders of TMT Trailer Ferry, Inc.* v. *Anderson*, 390 U.S. 414, 424 (1968). If the bankruptcy court had simply approved a compromise of the estate's fraudulent-transfer suit against Sun and CIT, while otherwise administering the case in a manner consistent with the Code's priority scheme, petitioners' status as priority creditors would not have given them any absolute right to veto that compromise.

The "settlement" that the courts below approved, however, did not simply convert the estate's fraudulent-conveyance action to money that would become part of the estate pursuant to 11 U.S.C. 541(a)(6). Rather, the agreement and order took the further step of distributing those assets in a manner inconsistent with Section 507. Even assuming that the bankruptcy court could have approved that disposition with the consent of all affected parties, it had no authority to abrogate the rights of nonconsenting creditors in a manner not provided for in the Code. The consent of *other* parties who benefitted from the proposed disposition is not a substitute for the consent of the impaired party. Cf. *Martin* v. *Wilks*, 490 U.S. 755, 768 (1989) ("A voluntary settlement in the form of a consent decree between one group of employees and their employer cannot possibly 'settle,' voluntarily or

otherwise, the conflicting claims of another group of employees who do not join in the agreement.").

The court of appeals purported to limit its approval of this type of disposition to cases in which a bankruptcy court has "specific and credible grounds to justify [the] deviation." Pet. App. 21a (citation omitted; brackets in original). But the grounds on which the court relied—that "there was 'no prospect' of a plan being confirmed and conversion to Chapter 7 would have resulted in the secured creditors taking all that remained of the estate in 'short order,'" *ibid.* (citation omitted)—are not permissible reasons to deviate from the Code's priority scheme over the objection of the impaired parties. If a plan cannot be confirmed and conversion to Chapter 7 is not feasible, the Code provides a third option: dismissal of the bankruptcy.

The court of appeals is correct that, "[a]s in other areas of the law, settlements are favored in bankruptcy." Pet. App. 19a. Both in bankruptcy and in other legal settings, however, the legal rules that establish parties' rights and obligations provide the background against which parties negotiate towards a settlement. In this context, the priority scheme in Section 507 provides the default rule that will govern if the parties fail to reach a global agreement. The public policy favoring settlement of litigation may justify deviations from the Code's priority scheme when a priority creditor consents to a diminution of its rights. But that policy provides no basis for the disposition that occurred here, in which the bankruptcy court approved the distribution of estate assets in a manner inconsistent with the Code's priority scheme *without* the

agreement of the creditors whose rights were impaired.

The related absolute priority rule under Section 1129 is designed to protect intermediate creditors from being squeezed out by a deal between senior and junior creditors. See 1977 Report 416 (explaining that the absolute priority rule "is designed to prevent a senior class from giving up consideration to a junior class unless every intermediate class consents, is paid in full, or is unimpaired"). Although the priority scheme in Section 507 has the same goal, the bankruptcy court in this case approved the very machination that the absolute priority rule is intended to prevent, with secured creditors and junior unsecured creditors taking all of the estate assets and leaving unconsenting priority unsecured creditors with nothing. If the bankruptcy court had enforced the Code's prohibition of that result, and had treated petitioners' consent as a precondition for approval of any disposition that impaired their rights under the Code, the parties might have reached a different global agreement that gave those priority creditors a share of the estate's assets. Cf. *Fundamentals of Bankruptcy* § 9.04(f)(1), at 425 ("[T]he lurking presence of the absolute priority rule influences the negotiating process over the terms of a plan. Seniors are willing to give up some limited reorganization value to juniors to achieve a consensual plan so as to avoid the time, expense, and risks that are involved in testing the rule. Juniors are motivated to make only reasonable demands because application of the absolute priority rule may result in their receiving nothing under the reorganization plan.").

3. In justifying its disposition of the case, the bankruptcy court relied on its own assessment of the strength of the various claims at issue. The court stated that petitioners would not be prejudiced by approval of the settlement because petitioners' WARN Act "claim against the estate is presently, effectively worthless given that the estate lacks available unencumbered funds to satisfy it if it were allowed." Pet. App. 61a. The court's view that petitioners' WARN Act claims were "worthless" rested on its belief that the estate's fraudulent-conveyance claim was too contingent and uncertain to merit pursuit. *Id.* at 60a-61a.

If the bankruptcy case had simply been dismissed, petitioners could have pursued a fraudulent-conveyance action against Sun and CIT on their own behalf as creditors of Jevic. And if that action had been successful, funds would have been available to satisfy Jevic's WARN Act obligations to petitioners. Of course, if petitioners shared the bankruptcy court's view that a fraudulent-conveyance action would have no realistic prospect of success, and that their WARN Act claims therefore were "effectively worthless," Pet. App. 61a, they might well have agreed to a global settlement that provided them only a very modest recovery. By approving a disposition of the case that abrogated petitioners' rights *without* their consent, however, the bankruptcy court pretermitted the negotiations that might have produced a truly global agreement.[2]

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[2] The bankruptcy court's assessment that petitioners' claims were "effectively worthless" because the estate's fraudulent-conveyance action was unlikely to produce any actual recovery, Pet. App. 61a, is difficult to square with the deal that was struck.

Within the bankruptcy case, Jevic (as debtor in possession) had the exclusive right to pursue (on behalf of all of its creditors) any claim that Jevic's assets had been depleted by a fraudulent conveyance. 11 U.S.C. 544(b) (assigning such claims to trustee); 11 U.S.C. 1107 (Chapter 11 debtor in possession has rights of trustee); see 11 U.S.C. 548(a) (trustee has exclusive right to pursue fraudulent-conveyance action in bankruptcy); see also *In re Cybergenics Corp.*, 226 F.3d 237, 241-245 (3d Cir. 2000); Patrick A. Murphy et al., *Creditors' Rights in Bankruptcy* § 13:5, at 469 (2d ed. 2014). The bankruptcy court initially authorized the Committee to pursue that claim on the estate's behalf. When the court subsequently approved the purported settlement, the fraudulent-conveyance claim against Sun and CIT (which belonged to Jevic's creditors) was dismissed with prejudice, precluding petitioners from pursuing it outside bankruptcy. See *In re PWS Holding Corp.*, 303 F.3d 308, 313-315 (3d Cir. 2002), cert. denied, 538 U.S. 924 (2003). The effect of the "settlement" thus was to deprive petitioners, without their consent and without complying with the Code's priority scheme, of a potentially valuable cause of action that they could have asserted if the bankruptcy case had simply been dismissed.

Although Sun presumably would have exited a Chapter 7 conversion with at least some of the $1.7 million that secured its assets, Sun and CIT together agreed to give up a total of $3.7 million (by paying $2 million to a fund for legal fees and administrative expenses, and by giving up the $1.7 million that secured Sun's lien) in exchange for a release from the fraudulent-conveyance claim (held at the time by the estate on behalf of Jevic's creditors). *Id.* at 5a.

* * * * *

The Bankruptcy Code is a detailed scheme that reflects Congress's determination of what constitutes a fair bargain for debtors and creditors in bankruptcy. And while the Code contemplates that creditors may consent to an impairment of the rights they would otherwise possess, petitioners did not give such consent here. The bankruptcy court's disposition of the case was not authorized by any Code provision, it contravened the Code's priority scheme, and it was entered over the objection of the priority creditors whose rights were impaired. The bankruptcy court's view that this result served the best interests of "the creditors as a whole" was a legally insufficient basis for the order that it entered, which deprived petitioners of their priority rights and their fraudulent-conveyance claim while giving them nothing in return.

CONCLUSION

The decision of the court of appeals should be reversed.

Respectfully submitted.

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